

ST 03-0153-GIL 10/07/2003 SERVICE OCCUPATION TAX

Generally, photocopy services and incoming facsimile services are considered sales of service. See 86 Ill. Adm. Code 140.101. (This is a GIL.)

October 7, 2003

Dear Xxxxx:

This letter is in response to your letter dated June 4, 2003, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at [www.ILTAX.com](http://www.ILTAX.com) to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

This is to request you to issue an advisory opinion on the application of sales and use tax on 'On site Copy and Fax center' services provided by us in the **State of Illinois**. The nature of service provided are described as below:

The Company will provide management services to manage on site Copy and Fax centers for clients at their location or at other locations within the State. The Company may provide personnel only, personnel and supplies, and/or personnel, supplies and equipment.

The management services include the following:

**On Site Copy and Fax Center**

At the Client's facility, the assigned personnel will make copies of original documents submitted by client and provide related copy services (binding, stapling, numbering, etc.). The Company provides the personnel, supplies and equipment required to produce copies.

At the Client's facility, the assigned personnel will operate facsimile equipment for incoming and outgoing faxes and deliver the faxes as per the client request.

All direct costs, administrative expenses and overhead are paid directly by the Company. All personnel provided by Company will be part-time or full-time permanent employees of the Company, paid by the Company, and entitled to benefits under the Company's policies. Generally, it is expected that personnel involved in these operations will work primarily at the client's facility, but occasionally separate facilities are established.

Generally, the machinery and equipment used by the Company at the client's premises in the copy center is rented or owned by the Company. On occasion the customer will sell its equipment to the Company who will then use the equipment to perform the services.

### **Billing for services rendered**

Under the contract the client is billed for a 'monthly management fee'. Generally, customers are billed for services under a one to five year contract terms at a monthly management fee for a defined level of services including

- a. An allowance covering a stated number of copies and facsimiles, all rental and other charges for the equipment provided by the company and all charges for related supplies.
- b. Fee for personnel, travel, staff support and other overhead costs.
- c. Management report and counseling to the customers.

For additional copies and facsimiles over the monthly allowance, a fixed price per copy/facsimile is charged to the client. The fixed price includes cost of supplies.

The contract also provides for overtime billing at a specified rate should the company's personnel work overtime on site.

All amounts paid under this contract are taxable gross receipts with no deduction for the cost of equipment, labor or service cost and others related materials used. The client is billed sales taxes on the entire gross receipts as per the contract.

We would like to have an advisory opinion on the following issues related to applicability of sale and use tax in the **State of Illinois**.

**Q. I: Would machinery or equipment purchased, rented or leased by the Company in connection with providing the services qualify for a sales and use tax exemption?**

**Q. II: Would supplies and materials purchased by the Company and used in the various operations be exempt from sales tax?**

**Q.III: Would all amounts paid under this contract be considered as taxable gross receipts? If yes, can we take deduction from gross receipt for the cost of equipment, labor or service cost and other related materials used in performing services under the contract? Should the client be billed taxes on the entire gross receipts as per the contract?**

You are requested to issue an advisory opinion based on the above stated facts. If you require additional clarifications, please call me.

Thank you for your assistance.

## **DEPARTMENT'S RESPONSE:**

We are answering your inquiry under the understanding that the clients your company will be providing copy and facsimile services to will be the end users of those services. If this understanding is not correct and such services are to be resold, then please see 86 Ill. Adm. Code 140.145 regarding multi-service situations.

### **Machinery & Equipment**

The exemption for graphic arts equipment and machinery was recently repealed by the Illinois legislature effective July 1, 2003. Please note that photocopying and facsimile equipment would not have qualified for the exemption. You have mentioned that some of the machinery or equipment may be leased. The State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See subsection (a)(3) of 86 Ill. Adm. Code 150.310.

Under Illinois law, lessors may not "pass through" their tax obligation to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq. There are also some limited

exceptions to the general rule described in the preceding paragraphs. There is an exemption from Retailers' Occupation Tax for sales of tangible personal property to lessors who lease that property to governmental bodies under leases of one year or longer. See 86 Ill. Adm. Code 130.2012. In addition, the sale of computers and communications equipment and equipment used in the diagnosis, analysis, or treatment of hospital patients is exempt when sold to lessors who lease that property under leases of one year or longer with hospitals to whom the Department has issued a tax exemption identification number. See 86 Ill. Adm. Code 130.2011.

## **Sales of Service**

Illinois Retailers' Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. For your general information see 86 Ill. Adm. Code 140.101 through 140.109 regarding sales of service and Service Occupation Tax.

Under the Service Occupation Tax Act, businesses providing services (i.e. servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See 86 Ill. Adm. Code 140.101. The purchase of tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. The serviceman's liability may be calculated in one of four ways: (1) separately stated selling price of tangible personal property transferred incident to service; (2) 50% of the servicemen's entire bill; (3) Service Occupation Tax on the servicemen's cost price if the servicemen are registered de minimis servicemen; or (4) Use Tax on the servicemen's cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. See 86 Ill. Adm. Code 140.109. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations. Such servicemen also collect a corresponding amount of Service Use Tax from their customers, absent an exemption.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Such

de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers. See 86 Ill. Adm. Code 140.108.

Generally, sales of facsimile and photocopy services are considered sales of service that may be subject to Service Occupation Tax liability, which is described in the above discussion. Tangible personal property that is transferred incident to document copying and facsimile services could fall below the de minimis threshold. If this is the case, it would allow such servicemen to determine their tax base in any of the above methods. Historically, most service providers that qualify as de minimis and are not otherwise required to register with the Department prefer to determine their tax base under the last method. Please note that if the facsimile and photocopy services provided by the company to its clients are to be resold, then see 86 Ill. Adm. Code 140.145 regarding multi-service situations.

I hope this information is helpful. If you require additional information, please visit our website at [www.ILTAX.com](http://www.ILTAX.com) or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Terry D. Charlton  
Associate Counsel

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